Appeal number: UT/2018/0039
[2019] UKUT 0133 (TCC)

CORPORATION TAX – oil companies – supplementary charge on ring fence profits – rate change – apportionment of profits before and after rate change – section 7 Finance Act 2011

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Appellants**
- and -	
(1) TOTAL E&P NORTH SEA UK LIMITED (2) TOTAL OIL UK LIMITED	**Respondents**

TRIBUNAL: JUDGE TIMOTHY HERRINGTON
JUDGE JONATHAN CANNAN

Sitting in public at the Royal Courts of Justice, Strand, London WC2A 2LL on 28 January 2019

Michael Jones instructed by the Solicitor's Office and Legal Services HM Revenue & Customs for the Appellants

Laurent Sykes QC instructed by Vinson & Elkins LLP for the Respondents

DECISION

Background

1. This is an appeal against a decision of the First-tier Tribunal (Tax Chamber) [2018] UKFTT 20 (TC) released on 9 January 2018. The FTT allowed an appeal by the respondents against certain decisions of the appellants ("HMRC"). Since January 2018 the respondents have changed their company names. At the time of the FTT decision they were Maersk Oil North Sea UK Limited and Maersk Oil UK Limited. For the sake of clarity and consistency we shall adopt the shorthand used by the FTT and refer to them as "MONS" and "MOUK" respectively, or together as "the Companies".

2. MONS appealed to HMRC against a notice of amendment to its self-assessment for accounting period ending 31 December 2011 which charged the company to additional tax of £2,395,540.00. MOUK appealed to HMRC against a closure notice following an enquiry into its self-assessment for the accounting period ending 31 December 2011, assessing the company to additional tax of £4,474,785.52.

3. There is no dispute in relation to the facts for the purposes of this appeal and we gratefully adopt what follows from the findings made by the FTT, together with additional undisputed facts referred to by the parties during the course of this appeal.

4. MONS and MOUK carry on oil related trades. They are subject to UK corporation tax on the profit of those trading activities as if they amount to a separate ring fenced trade in the UK (see *ss 270-279 Corporation Tax Act 2010*). The profits generated by these activities are referred to as ring fence profits.

5. UK tax legislation applies a supplementary tax charge, over and above normal corporation tax, on ring fence profits (see *s 330 Corporation Tax Act 2010*). The supplementary charge was at a rate of 20% from 1 January 2006 until 23 March 2011. On 23 March 2011 it was announced that the supplementary charge would be increased to 32% with effect from 24 March 2011.

6. Provision for the rate change was made in *Finance Act 2011* ("FA 2011"), including specific provision for companies with accounting periods straddling 23 March 2011, which will apply to most but theoretically not all companies with ring fence profits. Such companies are required to treat the periods before and after the rate change as two separate accounting periods and to apportion their profits between those periods on a time basis. In response to industry lobbying, an additional provision was included in the legislation where time apportionment of profits would work unjustly or unreasonably. In those circumstances companies could elect for a different basis of apportionment which was just and reasonable.

7. The corporation tax returns of MONS and MOUK for their accounting periods ended 31 December 2011 included such elections, made under s 7(5) FA 2011.

8. HMRC accepted that both MONS and MOUK were entitled to make elections under s 7(5) Finance Act 2011 because a time apportionment basis would be unjust or

unreasonable. However, they did not accept that the alternative basis of apportionment specified by MONS and MOUK was just and reasonable. HMRC suggested a different basis of apportionment for both MONS and MOUK which it contended would be just and reasonable.

9. In order to understand the competing arguments, it is necessary to understand a little about the businesses of MONS and MOUK during 2011 and why it was that both parties agreed that a time apportionment basis would work unjustly or unreasonably, although for different reasons.

10. During 2011 MONS was the operator of six oil fields in the North Sea: Gryphon, South Gryphon, Tullich, Boa, Lochranza and Dumbarton. MOUK also had an interest in the Dumbarton field. MONS had joint interests in three other fields where it was not the operator: Maclure, Harding and Wytch Farm.

11. The Gryphon, South Gryphon and Tullich fields all tied back to the Gryphon Alpha Floating Production and Storage Offloading vessel ("Gryphon FPSO"). There was a severe storm in the North Sea on 4 February 2011 and the Gryphon FPSO had technical problems. The FPSO lost power, four of its ten anchor chains failed and it moved off station by 100 metres, dragging sub-sea equipment with it and causing all of its risers to be disconnected. This led to the destruction of most of its subsea equipment. Extensive damage was also suffered to the FPSO itself. The result of this damage, referred to as the Gryphon incident, was that the Gryphon, South Gryphon, Maclure and Tullich fields all suffered a "shut in" pending repair to the equipment. The Gryphon field shut in lasted for two years.

12. MONS incurred capital expenditure of $245,885,402 after 24 March 2011, substantially in relation to the Gryphon incident but also accelerating some upgrade programmes. The FTT found at [13] that MONS received two insurance payments as a result of the Gryphon incident in 2011: (i) a payment of $266,298,078 "Loss of Production Insurance" and (ii) a payment of $55,039,192 "Property Damage Insurance". The property insurance payment resulted in a balancing charge arising for capital allowances purposes.

13. MONS' adjusted ring fence profit from all its oil and gas field operations in the period ending 31 December 2011 was £69,082,470. We were told that those profits were also affected by events in relation to Dumbarton described below, although it is not clear to what extent.

14. During 2011 MOUK had a licence share in three fields in the North Sea: Janice, Affleck and Dumbarton. It was also involved in two other fields where it was not the operator: Telford and Scott.

15. It is usual for fields to be shut in for periods where maintenance work is carried out. In the North Sea maintenance is carried out during the summer months because weather conditions are more favourable which causes profits to be lower in summer months. There was a two month shut in at Dumbarton in July and August 2011. Long term issues with the Janice Floating Production Unit ("FPU") to which the Janice and

Affleck fields were tied were also identified. A scheduled "shut in" at the Janice FPU was delayed and lasted for 12 days rather than the five days planned. A second planned shut in commencing on 24 October 2011 was expected to last 26 days but actually lasted 180 days. Hence, 69 of those days fell within the year ending 31 December 2011.

16. MOUK's adjusted ring fence profit from all its oil and gas field operations in the period ending 31 December 2011 was £48,094,717.

17. The Companies contended that the events described above meant that the profits of both companies for 2011 were concentrated in the early months of the year and as a consequence applying a time apportionment basis for profits would have worked unjustly and/or unreasonably.

The Issues

18. Section 7 FA 2011 so far as relevant provides as follows:

> "(3) Subsections (4) to (10) apply where a company has an accounting period beginning before 24 March 2011 and ending on or after that date ("the straddling period")
>
> (4) For the purpose of calculating the amount of the supplementary charge on the company for the straddling period –
>
>> (a) so much of that period as falls before March 24 2011, and so much of that period as falls on or after that date, are treated as separate accounting periods, and
>>
>> (b) the company's adjusted ring fence profits for the straddling periods are apportioned to the two separate accounting periods in proportion to the number of days in those periods.
>
> (5) But if the basis of apportionment in subsection 4(b) would work unjustly or unreasonably in the company's case, the company may elect for its profits to be apportioned on another basis that is just and reasonable and specified in the election.
>
> (6) The amount of the supplementary charge on the company for the straddling period is the sum of the amounts of the supplementary charge that would, in accordance with subsections (4) and (5), be chargeable on the company for those separate accounting periods."

19. The issue between the parties before the FTT was whether the basis of apportionment specified by the Companies in their elections under s 7(5) was just and reasonable. MONS and MOUK both specified the same basis of apportionment in their elections. This was referred to as the "actual basis" and involved the Companies calculating adjusted ring fence profits for separate accounting periods as if they each had two accounting periods, 1 January 2011 to 23 March 2011 and 24 March 2011 to 31 December 2011. We shall refer to these as "the Earlier Period" and "the Later

Period" respectively. The effect of the Companies' actual basis of apportionment was as follows:

	MONS $	MOUK $
Adjusted Ring Fence Profits	110,649,391	77,033,311
Companies' Actual Basis		
Earlier Period	112,762,117	113,028,916
Later Period	(2,112,726)	(35,995,605)
Apportionment on Actual Basis		
Earlier Period	110,649,391	77,033,311
Later Period	nil	nil

20. It is not entirely clear from the FTT decision but the parties confirmed to us that the real issue between the parties arises solely from the treatment of capital allowances in those calculations. In general, 100% first year allowances were available for qualifying expenditure in the accounting period in which the expenditure was incurred. The basis of apportionment adopted by MONS and MOUK involved capital allowances of $405,066,519 and $140,803,501 respectively being treated as incurred in the Later Periods, thus reducing the ring fence profits in those periods. The effect was to produce a notional loss in the Later Period for both Companies and a correspondingly increased profit in the Earlier Period. Hence, the Companies apportioned 100% of the ring fence profits for the period ending 31 December 2011 to the Earlier Period.

21. HMRC suggested an alternative basis of apportionment which removed what they considered to be the distorting effect of capital allowances being deducted almost entirely in the Later Period. In broad terms time apportionment was treated as the default basis of apportionment. Items not affected by the Gryphon incident and the shut ins, including capital allowances, continued to be time apportioned to the Earlier Period and the Later Period. Items which were affected such as the Loss of Production Insurance were apportioned between the period after the Gryphon incident and the Later Period rather than being included in the period of receipt.

22. The Companies' argument before the FTT and before us was essentially that this was not a just and reasonable basis of apportionment because it did not acknowledge that the exercise required apportionment of profits by reference to a "tax measure" of profits, unlike the Companies' basis of apportionment. The Companies contend that there can be no objection to calculating the actual profits for tax purposes in the two periods and apportioning the total profits on that basis.

23. A comparison may be made of the time apportionment basis, the Companies' actual basis and HMRC's proposed basis of apportionment of the ring fence profits for the year ended 31 December as follows:

	MONS	MOUK
Adjusted Ring Fence Profits	$ 110,649,391	$ 77,033,311
Time Apportionment		
Earlier Period	22%	22%
Later Period	78%	78%
Companies' Actual Basis		
Earlier Period	100%	100%
Later Period	0	0
HMRC Proposed Basis		
Earlier Period	71%	53%
Later Period	29%	47%

The FTT's Decision

24. The FTT identified the issue at [116] in the following terms:

"116. The question in this appeal boils down to how to deal with profits which are not smooth in a way which is just and reasonable, and particularly how to deal with the lumpiness caused by events giving rise to capital expenditure."

25. The FTT went on to consider HMRC's criticisms of the Companies' approach but concluded that the Companies' basis of apportionment was reasonable and just. It dealt with these two aspects separately as follows:

"Reasonable basis

138. I have concluded that the actual basis applied by Mrs Ritchie as the basis for MONS and MOUK's corporation tax calculations for the 2011 tax year is a reasonable basis of apportioning the companies' ring fence profits under s 7(5) FA 2011. I have come to this conclusion accepting that it has some shortcomings but also bearing in mind that:

(i) It is a method which is closely aligned to the method used by Mrs Ritchie for management accounting and reporting purposes; it is not a contrived method.

(ii) It relies on a consistent concept which has been applied (with minor errors) by Mrs Ritchie to both income and expenditure, which has not always worked in the Appellants' favour.

(iii) It is in line with the statutory context of s 7 FA 2011 which envisages treating the pre-and post March 24 2011 periods as separate accounting periods.

(iv) While not perfect, it provides a reasonable reflection of the financial results of the two companies for the relevant periods, including significant capital expenditure.

(v) It reflects the fact that first year capital allowances are not given on time apportioned basis, but on an incurred basis.

(vi) I have also taken account of the other examples referred to by Mr Sykes in which HMRC have accepted that first year allowances do not need to be time apportioned when accounting periods have been truncated.

Just basis

145. It seems to me that HMRC's main concern has been with the justness of the result of the application of Mrs Ritchie's method, because it has led to all of the profits of both companies being allocated to the low tax period prior to 24 March 2011.

146. I have also concluded that Mrs Ritchie's basis for attributing the profits of MONS and MOUK for the two periods before and after 24 March 2011 is just. I have come to this conclusion because:

(i) The context of s 7(5) is to solve a perceived unjust result. While the method adopted by the Appellants might not be perfect, it does provide a reasonable alternative to a time apportionment approach which answers the requirement of the legislation.

(ii) HMRC suggested that the Appellants had applied a contrived method to intentionally distort their profit profile. I do not accept this either in principle; the actual method was not contrived and was the one regularly used by Mrs Ritchie in her monthly financial reporting, or in practice; Mrs Ritchie allocated both income and expenses by reference to the same method, whether or not this gave rise to an advantage or a disadvantage for MONS or MOUK."

26. The FTT went on to consider whether it was appropriate to treat MONS and MOUK in the same way, apparently because MONS had suffered a much more significant disruption to its ring fence trade. The FTT concluded that if the approach was just and reasonable for MONS then it was also just and reasonable for MOUK.

The Grounds of Appeal

27. The FTT itself granted permission to appeal the decision. There are three grounds of appeal. Ground 1 challenges the FTT's interpretation and application of s 7 FA 2011. Ground 2 asserts that the FTT failed to take into account the outcome of the Companies' basis of apportionment in considering whether it was just and reasonable. Ground 3 asserts that the FTT wrongly accepted that the Companies' approach was a method of apportionment when in reality it was a re-computation of profits. The arguments in relation to each ground of appeal overlapped to some extent.

Ground 1

28. There are three aspects to the first ground of appeal relating to the interpretation and application of s 7 FA 2011. Firstly, HMRC contend that the FTT wrongly found that the purpose of s 7(5) FA 2011 was to alleviate problems for companies with "open accounting periods" on 23 March 2011 and to avoid retrospective taxation.

This was a submission made on behalf of the Companies' which the FTT accepted at [112].

29. Secondly, HMRC contend that the FTT wrongly found that s 7(5) was intended to provide relief for companies whose profits were not spread smoothly throughout the year. At [113] the FTT stated as follows:

> "113. [Section 7(5)] is intended to provide relief for companies whose profits are not smoothly spread throughout the year, but whose profits differ greatly from one part of the year to the other, and who could be disadvantaged by such a change of tax rate part way through an accounting period. The legislation recognises that a time apportionment method will work fairly for smooth profits, but it will be potentially unfair for lumpy profits."

30. Thirdly, HMRC contend that s 7 FA 2011 does not envisage treating the straddling periods as separate accounting periods for all purposes, but only for the limited purpose of apportioning the ring fence profits.

31. Mr Jones also submitted that the FTT wrongly described the issue at [119] where it said:

> "…all that is required for s 7(5) FA 2011 purposes is for profits to be taxed by reference to a basis which is neither unreasonable or unjust."

32. We agree with Mr Jones that the FTT's description in [119] wrongly suggests that a proposed basis of apportionment should be accepted unless it is shown to be unreasonable or unjust. However, we do not consider that this affected the ultimate decision reached by the FTT which was that the Companies' basis was just and reasonable.

33. In relation to the first aspect of ground 1, HMRC effectively contend that the FTT wrongly identified the purpose of s 7(5) which led it into error when it came to consider whether the Companies' basis of apportionment was just and reasonable.

34. It appears that the FTT relied on a response to the rate change from the oil industry dated 7 April 2011 which identified the possibility of retrospective taxation if there was no just and reasonable override (see [71] of the decision). Mr Jones on behalf of HMRC submitted that the FTT was not entitled to take into account such materials when it came to consider the purpose of s 7(5). He relied on the well-known line of authorities including *R v Secretary of State for the Environment ex parte Spath Holme Ltd* [2001] 2 AC 349 for the proposition that the intention of Parliament is to be discerned from the words it has used to express that intention and that any external aid to interpretation must be publicly available.

35. Mr Jones submitted that the words of s 7(5) indicate an intention only that time apportionment is the default basis, which may be displaced where in the particular circumstances of the taxpayer it is not just and reasonable. He submitted that it was difficult to discern anything beyond that intention.

36. Mr Sykes sought to persuade us that what was said in Parliamentary debates in relation to the Finance Bill 2011 support the FTT's conclusions. He also sought to rely on oil industry reaction to the announcement that the supplementary tax charge would be increased from 20% to 32% as part of the context and circumstances in which s 7(5) FA 2011 was introduced. He drew our attention to well-known extracts from the judgment of Lord Steyn in the House of Lords in *Westminster City Council v National Asylum Support Service* [2002] UKHL 38 to the effect that in statutory construction the context and surrounding circumstances must be taken into account.

37. We do not find it necessary to resort to external materials. It seems to us that Parliament's intention in providing what may be described as a just and reasonable override is clear from the wording of the provision itself. For various reasons there may be circumstances in which time apportionment of profits in the context of a rate change may operate unfairly. There may be circumstances where profits should fairly be seen as accruing in the period before an increase in the rate. The most obvious example is a single transaction realising a significant profit which is completed in the period before the rate change. If the new rate of tax is applied to that transaction then it may fairly be described in some senses as retrospective taxation where at the time of the transaction the rate change was not anticipated. We do not accept Mr Jones' first criticism of the FTT's decision. In our judgment the election was plainly intended to mitigate the effect of what might be described as retrospective taxation.

38. In relation to the second aspect of ground 1, Mr Jones submitted that the FTT's statement of the purpose of s 7(5) at [113] was not justified by the words of the statute. He submitted that time apportionment was the default position even for taxpayers whose profits are not spread smoothly throughout its accounting period. Any election for an alternative to time apportionment would be the exception rather than the rule. In support of that submission he relied on the FTT's finding that it was usual for oil and gas companies operating in the North Sea to have shut ins for maintenance work during the summer months which would cause profits to be lower in the summer months. Hence, one would not expect smooth profits in any event.

39. Mr Sykes submitted that the FTT had not in fact said at [113] that time apportionment was intended to apply only to those companies with "smooth profits" throughout the accounting period. He submitted that the approach of the FTT was that time apportionment may remain a just and reasonable method where profits were not entirely smooth. Hence the FTT's reference to profits which "differ greatly" in [113]. Further, the FTT acknowledged at [114] that the basis on which HMRC accepted that the Companies could make an election under s 7(5) was because the Companies' profits were "sufficiently irregular" to give rise to a disadvantage.

40. Mr Sykes criticised HMRC's submissions as being predicated on the basis that the election under s 7(5) should only be available in exceptional circumstances which was not supported by the terms of the legislation.

41. The FTT made a finding at [28] to the effect that oil and gas companies operating in the North Sea would usually be expected to have lower profits in the summer months. At [113] the FTT went on to distinguish between what it described

as "smooth" and "lumpy" profits and identified that time apportionment might be "potentially unfair" for lumpy profits. If the FTT had found that s 7(5) was intended to provide relief for companies whose profits were not smoothly spread throughout the year then that would have been a generalisation which could not properly be discerned from the words of the statute or the context of the provisions. We do not consider that is what the FTT was saying in [113]. What can be discerned is that Parliament recognised that in certain circumstances time apportionment would not be just and reasonable, in which case an alternative basis of apportionment could be used. It seems to us that is why the FTT referred to time apportionment being "potentially unfair". In our view, variations in profit levels in an accounting period may mean that time apportionment is unjust or unreasonable depending on the cause and context in which those variations arise.

42. In relation to the third aspect of ground 1, both parties relied on the operation of s 93(1) Finance Act 2002 which was enacted when the supplementary charge was first introduced with effect from 17 April 2002. A similar approach was taken to identifying profits before and after the introduction of the supplementary charge in s 93(1) as follows:

> "(1) In the case of a straddling period, that is to say, an accounting period which begins before 17th April 2002 and ends on or after that date—
>
> (a) sections 501A and 501B of the Taxes Act 1988 (which are inserted by sections 91 and 92) shall apply as if so much of the straddling period as falls before 17th April 2002, and so much of that period as falls on or after that date, were separate accounting periods; and
>
> (b) all necessary apportionments between the two separate accounting periods shall be made in proportion to the number of days in those periods."

43. The reference to sections 501A and 501B are to what were precursors to the supplementary charge now found in section 330 Corporation Tax Act 2010.

44. Mr Sykes relied upon HMRC guidance in relation to s 93, which required a separate calculation of the profits in the two separate accounting periods. He submitted that a "very slight difference in wording" did not justify a different approach to s 7 FA 2011.

45. Mr Jones argued that s 93(1)(a) required a separate calculation of the profit in each separate accounting period, rather than an apportionment of the profit calculated for the whole accounting period. It seems to us that is right. The concept of apportionment only arises in s 93 in relation to specific items which it might be necessary to apportion to calculate the profit in each period. Hence the reference to "all necessary apportionments" in the plural. We are satisfied that s 7(4) envisages a different exercise to s 93(1). It requires an apportionment of the profit for the whole accounting period rather than a separate calculation of the profit in each period. The FTT was therefore wrong to conclude as it did at [127] that there is no discernible difference between the wording of s 7(4) and s 93. We are satisfied that Parliament

did not intend there to be a recalculation of profits for the Earlier Period and the Later Period. It intended an apportionment of the profits for the whole period.

46. That does not necessarily mean that what the Companies have done is not an apportionment. The starting point must be the adjusted ring fence profits for the whole accounting period. Where it is accepted that time apportionment is not a just and reasonable basis, taxpayers can elect for another basis to apportion the profits which is just and reasonable.

47. More generally, we do agree with Mr Jones that time apportionment was intended to be the default position. Otherwise the statute would simply have made provision for oil companies to be treated as having two separate accounting periods, with profits being calculated separately for each period for the purpose of the supplementary charge. That was the position on the introduction of the supplementary charge pursuant to s 93 but we are satisfied that Parliament intended a different approach in 2011 when the rate was increased. As a general rule time apportionment will apply unless, for reasons specific to the company, time apportionment would work unjustly or unreasonably. Hence the reference in s 7(5) to time apportionment working unjustly or unreasonably "in the company's case". In other words, factors which affect companies generally, such as shut ins for maintenance during the summer months, would not be expected to make time apportionment unjust or unreasonable.

48. In relation to ground 1, whilst the FTT was wrong in its comparison of s 7(4) FA 2011 and s 93(1) FA 2002 we do not consider that the FTT erred in law in identifying the purpose of s 7(5) as HMRC contend.

Ground 2

49. HMRC contend that the FTT failed to consider whether the Companies' basis of apportionment produced a just and reasonable result as a way of testing whether it was a just and reasonable basis. If it had done so then it would have been clear that the result and the basis of apportionment were not just and reasonable.

50. The FTT certainly recognised that it was relevant to consider whether the result was just and reasonable when assessing the Companies' basis of apportionment. It stated at [121]:

> "121. Asking whether a method produces a just and reasonable result is one way of testing whether a method is just and reasonable; but a method is not necessarily unjust and unreasonable only because it produces a result which may not align with one party's preferred result."

51. HMRC contend that whilst the FTT expressly recognised the relevance of the result, the FTT did not in fact consider the result when it concluded that the Companies' basis of apportionment was just and reasonable. In particular, the FTT failed to note the following factual matters which we understand are not in dispute between the parties:

(1) The result for MONS was that 102% of its adjusted ring fence profits were treated as arising in the Earlier Period. This is despite the fact that 65% of its turnover and 63% of its operating expenses were incurred on or after 24 March 2011, and the Gryphon incident affected only four of the nine fields in which MONS was interested.

(2) The result for MOUK was that 147% of its adjusted ring fence profits were treated as arising in the Earlier Period. This is despite the fact that 62% of its turnover and 80% of its operating expenses were incurred on or after 24 March 2011 and the overrun of the shut-in of the Janice FPU affected only the end of MOUK's accounting period.

52. HMRC contend that when one looks at the result in light of the circumstances of the Companies it cannot be just and reasonable. In particular, the Companies' basis of apportionment results in all the profits for the accounting period being apportioned to the Earlier Period, whether or not those profits arose from a source affected by the unexpected events. If the Companies were right in their approach then any oil company could simply identify one respect in which time apportionment did not work justly or reasonably and use that as a means to re-compute and allocate all the profits to the Earlier Period.

53. Mr Sykes accepted that in considering whether a basis of apportionment was just and reasonable it was necessary to look at the result. He submitted that the FTT had done just that at [138(ii)] when it noted that the Companies' basis did not always work in their favour. This was a reference to the treatment of loss of production insurance which we do not need to explore for present purposes.

54. Mr Sykes further submitted that HMRC were seeking to compare the result of time apportionment to the result of the Companies' actual basis by reference to an economic measure of profits. For example, by reference to turnover, operating expenses or accounting profit. He submitted that was an incorrect comparison and was not comparing like with like. He submitted that the comparison must be to the tax measure of profits, including the effect of capital allowances. The tax measure of profits took into account that first year capital allowances were given by reference to the date on which the expenditure was incurred. That was the reason for the difference between time apportionment and the actual basis of apportionment of profits for tax purposes in the two separate accounting periods. It is well known that the calculation of profits and losses for tax purposes will often differ to the accounting profit or loss. He referred us to a decision of Tribunal Judge Falk (as she then was) in *Bayliss v HM Revenue & Customs* [2016] UKFTT 0500 where it was stated:

> "61(3) …The tax system is highly complex and there are many instances where the calculation of a profit or loss for tax purposes differs markedly from the economic profit or loss. In some cases the fisc benefits from the difference and in other cases it does not…"

55. In support of those submissions Mr Sykes said that in using the concept of just and reasonable it was implicit that the legislation must have intended there to be a comparator. He submitted that comparing the time apportioned ring fence profits to

the tax profits apportioned on the Companies' actual basis was more of an objective exercise than that proposed by HMRC. Indeed, he submitted that HMRC had no yardstick against which to compare the time apportioned profits.

56. Mr Sykes relied on the fact that s 7(5) required the Companies' accounting periods to be treated as two separate accounting periods as indicating that Parliament intended the comparison to be to a tax measure of profits. He criticised HMRC's submission that a method of apportionment must take into account the various economic measures described above because they failed to take into account the significant capital expenditure incurred in the Later Period. This is the key dispute between the parties.

57. Mr Sykes also relied on other areas of tax law where an apportionment was permitted by reference to a tax measure of profits, for example in applying the group relief provisions in relation to losses. We are satisfied that no help is to be derived from the fact that in other areas such as group relief HMRC accept that first year allowances do not need to be time apportioned when accounting periods have been truncated.

58. Mr Jones submitted that there was no need for a comparator as such. HMRC were not seeking to compare a tax calculation of profits with an economic calculation of profits. Rather, Mr Jones submitted that one should test the result by reference to the circumstances of the Companies, the factors which made time apportionment unjust or unreasonable and how the alternative basis addresses those factors. He noted the reference in s 7(5) to the time apportionment basis working unjustly or unreasonably "in the company's case" which he took to be a reference to the specific circumstances of the taxpayer. If the Companies were right, then there was no reason s 7 should not have adopted the same approach as s 93 FA 2002 on the introduction of the supplementary charge.

59. We accept Mr Jones' submissions. As we have said, it is factors which are specific to the company which must cause s 7(5) to be engaged rather than factors which affect all companies in the same or a similar way. Further, it would not be just or reasonable if the alternative basis of apportionment went further than was necessary to counteract or compensate for the effect of those factors. Such an approach is just because it ensures that all taxpayers would be taxed on the same time apportionment basis, subject only to any necessary adjustments arising from the particular circumstances of the taxpayer electing a different basis of apportionment.

60. It is the treatment of first year capital allowances which lies at the heart of this appeal. Mr Sykes pointed out that the effect of the Companies' apportionment was not surprising because it was consistent with the availability of first year allowances generally. First year allowances are available in full even where the accounting period in which they are incurred is less than 12 months. Further, HMRC treated first year allowances in the same way when the supplementary charge was first introduced in 2002.

61. We do not accept Mr Sykes submissions about the relevant comparator. They are premised on the basis that identifying a tax measure of profits for the Earlier Period and the Later Period and apportioning the profits by reference to those tax measures of profit must be just and reasonable. However, that fails to take into account what we consider to be the intention behind s 7(5). Namely, that in the ordinary course time apportionment is just and reasonable even where profits are not smooth. Where it is not just and reasonable the alternative basis should operate only to the extent necessary to compensate for those factors specific to the company which led to time apportionment not being just and reasonable.

62. In our view the position is illustrated starkly in relation to MOUK. The profits of MOUK were reduced principally by an unexpected shut in during the last 6 weeks of 2011. The basis of apportionment proposed by MOUK has the effect that all of its profits for 2011 are apportioned to the Earlier Period. The parties agreed that this is because capital allowances are treated as being incurred in the Later Period. In our view that cannot be a just and reasonable apportionment when one considers the position of other taxpayers who must time apportion their profits. The alternative basis of apportionment goes beyond what is necessary to compensate for the effects of the shut in.

63. We are satisfied that the FTT did not properly take into account the result of the Companies' basis of apportionment. In particular, it did not consider whether the Companies' basis of apportionment was limited to what was necessary and sufficient to ensure that the apportionment was just and reasonable.

64. In the circumstances we are satisfied that the decision of the FTT contains an error of law.

Ground 3

65. HMRC contend that the Companies' actual basis of apportionment was not in fact an exercise in apportionment at all, but was an exercise which re-computed the ring fence profits for the two separate accounting periods. Instead of starting with the ring fence profits for the year ended 31 December 2011 and apportioning those profits between the two accounting periods, the Companies started with a blank sheet of paper and computed the profits as if there were two separate accounting periods.

66. This was a distinction which HMRC had drawn before the FTT and the FTT dealt with it at [125] as follows:

> "125. I do not accept that there is a complete distinction between the concept of apportionment and the concept of calculation; there is a place where the two overlap, and one of those places is in deciding when capital expenditure should be treated as incurred for tax purposes. For this reason, I do not accept Mr Jones' interpretation of the legislation's reference to the "re-allocation of adjusted ring fence profits" as excluding any element of re-calculation."

67. Mr Sykes effectively submitted that the legislation is silent as to the mechanics of the apportionment, other than requiring it to be just and reasonable. There was nothing to prohibit elements of re-computation in arriving at a basis for apportionment by reference to components of the profit to be apportioned. He submitted that the FTT was right in what it had said at [125].

68. Mr Sykes relied on *Marshall Hus & Partners v Bolton* 55 TC 539. In that case the taxpayer had produced one set of accounts covering six accounting periods and argued that it was required by the relevant provisions of the Income and Corporation Taxes Act 1970 to time apportion the profits to the six accounting periods. The Crown successfully argued that apportionment was necessary only if another method was not reasonably available and that on the facts the actual profit in each accounting period could reasonably be calculated. There are superficial similarities to the present appeal but the result in that case depended on the proper construction of the relevant statutory provision and the reasoning does not help in the present appeal.

69. HMRC contend that the FTT was wrong to conclude that the Companies' basis of apportionment was a just and reasonable basis because it amounted to re-calculation rather than apportionment. In setting out its reasons at [138] onwards HMRC say that the FTT was wrong to make the findings in sub-paragraphs (iv), (v) and (vi). Namely the fact that the Companies' method "*provided a reasonable reflection of the financial results of the two companies for the relevant periods, including significant capital expenditure*", reflected "*the fact that first year capital allowances are not given on time apportioned basis, but on an incurred basis*" and was consistent with other situations where "*HMRC have accepted that first year allowances do not need to be time apportioned when accounting periods have been truncated*".

70. In our view the FTT was right to acknowledge that apportionment may include an element of re-calculation. However, the FTT assumed that once time apportionment was acknowledged to be unjust and unreasonable then an apportionment based on a re-computation of the profits for the Earlier Period and the Later Period including a deduction for first year allowances in the period the expenditure was incurred must be just and reasonable. We do not agree, for reasons we have set out in relation to ground 2. Having said that, it does not appear to us that HMRC's arguments under ground 3 add much if anything to their arguments under ground 2 which we have accepted.

Remaking the decision

71. We have found that the FTT erred in law when it considered the result of the Companies' basis of apportionment. It ought to have considered whether the result went beyond what was necessary to compensate for the factors which made time apportionment unjust or unreasonable. In the circumstances we set aside the decision of the FTT and we shall re-make the decision.

72. We can do so quite shortly in the light of our findings as to the purpose of s 7(5) and how one identifies whether an alternative basis of apportionment is just and

reasonable. The parties acknowledge that the effect of the Companies' basis of apportionment is to treat all profits as arising in the Earlier Period because the capital expenditure was incurred in the Later Period. On the facts of this case that basis of apportionment plainly goes beyond what is necessary to compensate for the effects of the Gryphon incident and the shut ins affecting the Dumbarton field and the Janice FPU. We are satisfied that it is not a just and reasonable apportionment for the purposes of s 7(5).

73. It is not necessary for us to say whether HMRC's alternative basis would be a just and reasonable apportionment, and Mr Jones did not invite us to do so. In remaking the decision therefore, the appeal of MONS against the amendment of its self-assessment for accounting period ending 31 December 2011 and the appeal of MOUK against the closure notice dated 16 November 2015 are dismissed.

Disposition

74. For the reasons given above we allow HMRC's appeal and re-make the decision as described.

JUDGE TIMOTHY HERRINGTON
JUDGE JONATHAN CANNAN

RELEASE DATE: 1 May 2019